REPORT OF
FINANCIAL EXAMINATION

ESSENCE INC.

As Of
December 31, 2005

STATE OF MISSOURI

DEPARTMENT OF INSURANCE

JEFFERSON CITY, MISSOURI

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June 15, 2006
St. Louis, Missouri

Honorable Alfred W. Gross, Commissioner
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
Chair of the NAIC Financial Condition (E) Committee

Honorable Ann Womer Benjamin, Director
Ohio Department of Insurance
Secretary of the Midwestern Zone, NAIC

Honorable W. Dale Finke, Director
Missouri Department of Insurance
301 West High Street, Room 630
Jefferson City, MO 65101

Lady and Gentlemen:

In accordance with your financial examination warrant, a comprehensive financial examination has been made of the records, affairs and financial condition of

Essence Inc.

also referred to as "Essence" or the "Company." The examination was conducted at Essence's home office at 12655 Olive Blvd., Saint Louis, MO 63141, telephone number (314) 851-3600. This examination began on April 3, 2006 and concluded June 15, 2006.

SCOPE OF EXAMINATION

Period Covered

A pre-licensing examination of Essence Inc. was performed as of May 14, 2003. The examination was conducted by an examiner from the state of Missouri. Essence was granted a certificate of authority on May 30, 2003. Essence commenced business July 1, 2004.

The current full scope association financial examination covers the period from July 1, 2004 through December 31, 2005. The examination was conducted by examiners from the state of Missouri representing the Midwestern Zone of the NAIC. No other zones participated in this examination.

This examination also included material transactions or events occurring after December 31, 2005.

PRIOR EXAMINATION COMMENTS AND RECOMMENDATIONS

The comments and recommendations from the Pre-Licensing Examination, as of May 14, 2003, are listed below. The Company's response and the item's current status are also indicated.

Comment: Holding Company, Subsidiaries and Affiliates
"The Company must file an Insurance Holding Company System Registration Statement within fifteen days of the issuance of its Certificate of Authority."

Company response:
"Essence will file an Insurance Holding Company System Registration Statement within fifteen days of the issuance of its Certificate of Authority."

Current findings:
The Company received its Certificate of Authority on May 30, 2003. On June 13, 2003, the Company filed an Insurance Holding Company System Registration Statement with the Department.

Comment: Intercompany Transactions
"Essence must receive approval from the Missouri Department of Insurance prior to execution of the proposed Intercompany Services Agreement. The Guaranty Agreement also must be approved by the Missouri Department of Insurance upon issuance of a Certificate of Authority pursuant to Section 382.195.1(4) RSMo. (Insurance Holding Companies - Transactions Within a Holding Company System)."

Company response:
"Essence will file the proposed Intercompany Services Agreement and Guaranty Agreement, along with the "Form D-Prior Notice of a Transaction" required for each document, with the Missouri Department of Insurance and seek the approval of the Missouri Department of Insurance prior to Essence's execution of those documents. We expect that those documents will be filed this week with the Missouri Department of Insurance."

Current findings:
The Intercompany Services Agreement and the Guaranty Agreement were filed with the Missouri Department of Insurance. The Department indicated it had no intention of disapproving the agreements.

Comment: Reinsurance
"It is recommended that the Company not enter into the "Excess Loss Reinsurance Agreement" in its current form, as wording must be added addressing the insolvency clause. The Company must obtain approval from the Missouri Department of Insurance for its reinsurance contract prior to execution."

Company response:
"Essence will not enter into the "Excess Loss Reinsurance Agreement" in its current form. We have spoken with the Allianz broker regarding the additional insolvency clause that must be added. Based on that conversation and since the additional provision is a regulatory requirement, we do not anticipate a problem with Allianz regarding the additional insolvency clause that must be added. After the Excess Loss Reinsurance Agreement has been revised to contain the additional insolvency clause, we will file the Excess Loss Reinsurance Agreement with the Missouri Department of Insurance."

Current findings:
The Company's reinsurance agreement with Allianz contains an insolvency clause. On May 27, 2004, the Department indicated it had no intention of disapproving the agreement.

HISTORY

General

Essence was organized under the laws of the state of Missouri on January 30, 2003. On that same date, the Missouri Secretary of State approved the fictitious name Essence Healthcare. On February 7, 2003, the Missouri Secretary of State issued a certificate of corporate good standing to Essence. On May 30, 2003, the Director of the Missouri Department of Insurance issued a certificate of authority to Essence, licensing the Company as a health maintenance organization under Sections 354.400 through 354.636 RSMo.

Capital Stock

The Company's articles of incorporation authorize the issuance of up to 30,000 shares of common capital stock with par value of one dollar per share. As of December 31, 2005, the Company had 750 shares issued and outstanding. The Company's parent, American Multispecialty Group, Inc. d/b/a Esse Health ("Esse"), owns all of the Company's outstanding stock.

Essence was initially capitalized on March 5, 2003 with the issuance of 90 shares of common capital stock to Esse at a price of $5,000 per share. On May 14, 2003, an additional 410 shares of stock were issued to Esse at a price of $5,000 per share. On September 23, 2005, the board authorized issuing 250 shares of stock to its parent for $5,000 per share. As a result of these transactions, at year-end 2005 the Company reported $750 in outstanding common capital stock and $3,749,450 in gross paid in and contributed surplus.

Dividends

No dividends have been declared or issued since the Company's inception.

Management

Essence's by-laws vest the management of the Company in a board of directors. The initial board of directors was selected in March 2003 for staggered terms of two or three years. The directors serving as of December 31, 2005 were as follows:

Name	Affiliation
Charles J. Willey St. Louis, MO	Chief Executive Officer Essence Inc.
John H. Rice St. Louis, MO	Vice-President Essence Inc.
Martha E. Butler St. Louis, MO	Chief Operating Officer Essence Inc.
Richard L. Lazaroff St. Louis, MO	Physician
Debra K. Gribble St. Louis, MO	Senior Vice-President Essence Inc.
Paul A. Beuttenmuller St. Louis, MO	Chief Financial Officer Essence Inc.

Officers serving as of December 31, 2005 were as follows:

Name	Office
Charles J. Willey	President
Paul A. Beuttenmuller	Secretary-Treasurer
John H. Rice	Vice-President

The following committees were established as of December 31, 2005:

Committee	Chair(s)
Quality Improvement Committee	Kathleen Brunts and Don Richardson
Utilization Management Committee	John Wiedner
Compliance Committee	Richard Lazaroff
Credentialing Committee	John Rice
Pharmacy & Therapeutics Committee	Charles Willey
Member Advisory Committee	Dawn Walter
Peer Review Committee	Mark Irwin

Conflict of Interest

Essence has a policy requiring officers, directors and employees to complete conflict-of-interest disclosure statements on an annual basis. However, signed conflict-of-interest disclosure statements were not completed by all directors for each year under examination. The Company should ensure that signed conflict-of-interest disclosure statements are executed annually by all officers and directors.

Corporate Records

Essence's articles of incorporation and by-laws were reviewed. On February 22, 2005 the by-laws were amended to establish a members' advisory committee. On June 1, 2005, the by-laws were amended to reflect the Company's new home office address. Both amendments to the by-laws were approved by unanimous written consent of the board of directors.

The minutes of the board of directors meetings for the period under examination were also reviewed. The minutes appear to properly reflect and approve corporate transactions and events for the period under examination.

Acquisitions, Mergers and Major Corporate Events

The Company was not directly involved in any acquisitions, mergers or major corporate events during the current examination period.

Surplus Debentures

Since December 31, 2003, the Company has issued six surplus debentures to its parent, American Multispecialty Group, Inc. The date, amount and annual interest rate for each note are as follows:

Note	Dated	Amount	Rate
1	31-Dec-2003	$ 500,000	4.0%
2	15-Jun-2004	1,500,000	4.0%
3	30-Sep-2004	600,000	4.5%
4	31-Dec-2004	750,000	5.0%
5	31-Mar-2005	500,000	5.5%
6	30-Dec-2005	300,000	7.25%
Total		$ 4,150,000	

Each note was duly authorized by a resolution of the board. Each note received approval from the Director, Missouri Department of Insurance. Interest payments and repayment of principal are subject to prior approval from the Missouri Department of Insurance. No interest or principal payments were made during the examination period.

AFFILIATED COMPANIES

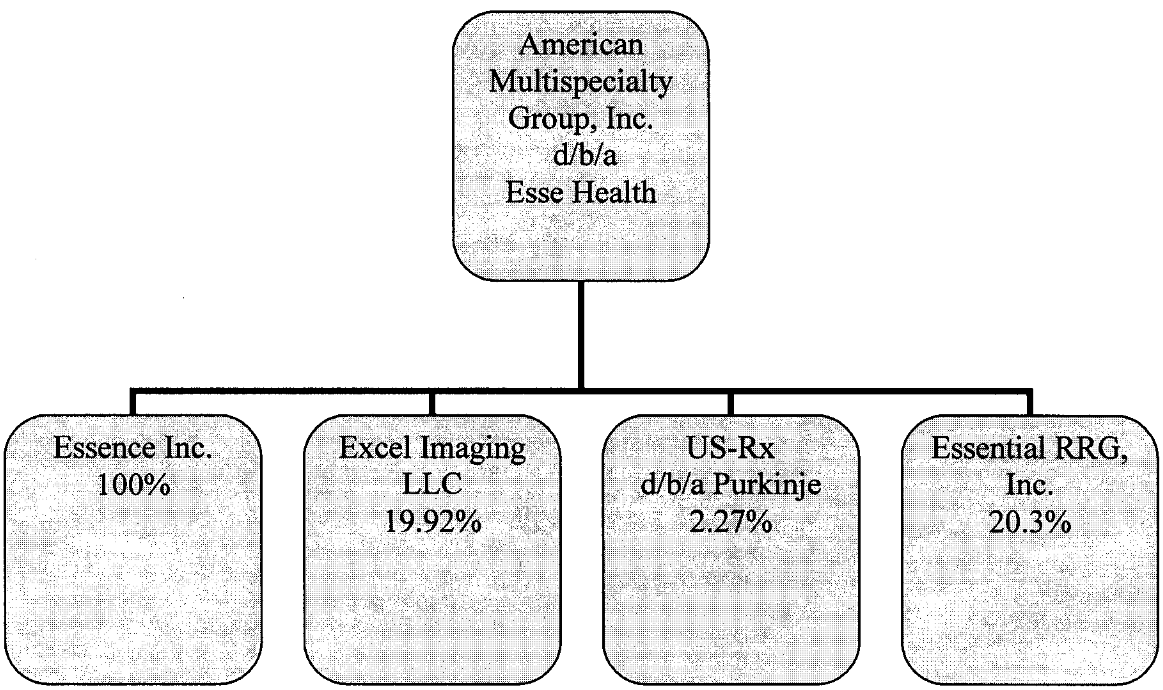
Holding Company, Subsidiaries and Affiliates

Essence is a member of an Insurance Holding Company System as defined by Section 382.010 RSMo (Definitions). Essence is a wholly owned subsidiary of American Multispecialty Group, Inc. d/b/a Esse Health.

Insurance Holding Company System annual registration forms were filed on behalf of the Company for each year under examination.

Organizational Chart

The following organizational chart depicts the holding company system at December 31, 2005.



Intercompany Transactions

<u>Guaranty Agreement</u>

Essence and Esse entered into a guaranty agreement effective March 31, 2003. Under the agreement Esse is obligated to provide Essence with sufficient capital to maintain required levels of reserves, net worth and surplus. Capital contributions may be made through subordinated indebtedness or in exchange for additional shares of Essence stock. Through year-end 2005, Esse contributed $4.15 million to Essence in surplus notes. (Refer to Surplus Notes for further details.)

Intercompany Services Agreement

Essence entered into a services agreement with Esse effective April 7, 2003. Services to be provided by Esse include:

- human resources, including payroll services and employee benefits administration
- finance, including banking services, cash management and investment administration, underwriting and actuarial services, and billing, collection and payment of premiums, fees and other amounts
- accounting, including preparation of financial and other accounting documents and reports, and preparation of tax returns
- information systems, including computer support and database maintenance, data processing services and telecommunications services
- marketing, including advertising, sales promotion, community affairs, public relations and policyholder services
- purchasing, including mail service, purchase and delivery of supplies and purchase or leasing of service equipment
- medical claims benefits administration, including medical claims review and adjudication, administration of appeals and regulatory and compliance services
- provider contracting and network management

Under the agreement Essence reimburses Esse for direct and indirect costs, including overhead, incurred in providing the contracted services. Esse bills Essence on a monthly basis; payment is due within 30 days. Amounts incurred by Essence under this agreement for the years under examination were:

2004	$ 740,945
2005	$ 1,378,008

Intercompany Tax Allocation Agreement

Esse and its subsidiaries, including Essence, are parties to a tax allocation agreement. Beginning with the tax year ending December 31, 2003 and for all subsequent years in which a consolidated return is allowed, Esse and its subsidiaries will file a consolidated federal income tax return. The tax liability or refund for each subsidiary is calculated as if the subsidiary filed a separate tax return. Any tax amount due under such calculation shall be paid to Esse. Any refund due under such calculation will be paid by Esse.

Sublease

Essence and Esse are parties to a sublease. Under the sublease, Essence rents approximately 6,300 square feet of office space from Esse. Annual rent is $108,944, payable in monthly installments of $9,078.68. Essence is also responsible for paying a share of the expenses, taxes and additional rent paid by Esse under the primary lease agreement. The sublease agreement terminates May 31, 2015.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on an employee dishonesty policy that provides $100,000 coverage per occurrence. This coverage meets the requirement of RSMo 354.425 Bonding of officers who disburse or invest funds--bond requirements.

The Company also maintains the following insurance coverage: business personal property; general liability; directors and officers; errors and omissions; and workers' compensation. The Company's insurance coverage appears adequate.

EMPLOYEE BENEFITS

Essence employees receive a variety of benefits including paid time off, medical insurance, dental insurance, group life, accidental death or dismemberment insurance, long-term disability insurance, short-term disability insurance, a 401(k) plan and tuition reimbursement.

INSURANCE PRODUCTS AND PRACTICES

Territory and Plan of Operations

Essence is licensed as a health maintenance organization under sections 354.400-354.440 RSMo. Essence provides Medicare + Choice coverage. At year-end 2005, Essence was licensed in Missouri, Illinois and Washington. However, the Center for Medicare and Medicaid Services ("CMS") has not authorized Essence to provide coverage in Washington.

As a Medicare provider, Essence is regulated by CMS. CMS pays Essence a monthly fee for each member enrolled.

Policy Forms & Underwriting; Advertising & Sales Materials; Treatment of Policyholders

The Missouri Department of Insurance has a market conduct staff that performs a review of these issues and generates a market conduct report. There has been no market conduct examination of Essence since its inception.

Essence's advertising materials were reviewed. There were no items of concern noted. Essence's grievance procedure was also reviewed. Essence appears to have procedures in place for the proper handling of complaints.

REINSURANCE

The Company's reinsurance and premium activity on a direct written, assumed and ceded basis for the period under examination is detailed below:

PREMIUM:	2004	2005
DIRECT	$ 448,679	$ 13,273,955
CEDED	7,144	292,327
NET PREMIUM	$ 441,535	$ 12,981,628

Ceded

The Company participates in an agreement with Allianz Life Insurance Company of North America ("Allianz"). The effective date of the agreement is January 1, 2005. The agreement provides for retention of either $50,000 (for Midwest Medical Associates members) or $100,000 (all other members). Allianz reimburses Essence for 90% of eligible charges in excess of the retention. The agreement includes a $2,000,000 lifetime maximum per individual. Allianz charges a monthly premium of $8.76 per member for members not serviced by Midwest Medical Associates. For Midwest Medical Associates members the monthly premium is $34.38 per member.

ACCOUNTS AND RECORDS

Essence prepares its financial statements based on statutory accounting principles. Accounting entries are recorded using Great Plains accounting software. The Company uses FACETS software for policy administration and claims administration. Great Plains has an integration manager application that allows information to be imported from FACETS in text format.

Maher and Company PC, a public accounting firm, audits the Company's financial statements on an annual basis. The most recent audit work papers were reviewed. The work papers were used in the course of the examination as deemed appropriate.

Timothy D. Courtney, FSA MAAA, reviewed and certified the reserves and related actuarial items reported in the financial statements. Mr. Courtney is associated with Reden and Anders, Consultants and Actuaries.

The Missouri Department of Insurance retained a consulting actuary, Milliman Consultants and Actuaries ("Milliman"), to review the adequacy of the Company's reserves and related liabilities. The consulting actuary proposed increases in the unpaid claims and unpaid claims adjustment expense reserves which are reflected in the financial statements below. The actuary also made the following recommendations:

"It is recommended that a margin (for adverse deviation) be included (in the unpaid claims liability) per Section 3.3.1c of the Actuary Standard of Practice #5 and Section III.G of the NAIC Health Reserves Guidance Manual.

"As the Company has a relatively small population and limited experience, the Company should monitor the behavior of large claims in the future to determine the method for handling such claims."

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company as of December 31, 2005, and the results of operations for the fiscal period then ended. Any examination adjustments to the amounts reported in the financial statements or comments regarding such are made in the "Notes to the Financial Statements" which follow the financial statements.

There may have been additional differences found in the course of this examination which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial in relation to the financial statements, and therefore were only communicated to the Company and noted in the work papers for each individual financial statement item.

ASSETS

	ASSETS	NON ADMITTED ASSETS	NET ADMITTED ASSETS
CASH AND SHORT-TERM INVESTMENTS	$ 3,761,392	-	$ 3,761,392
UNCOLLECTED PREMIUMS	119,893	-	119,893
AMOUNTS RECOVERABLE FROM REINSURERS	20,190	-	20,190
NET DEFERRED TAX ASSET	1,712,000	1,436,000	276,000
EDP EQUIPMENT AND SOFTWARE	285,191	239,680	45,511
FURNITURE AND EQUIPMENT	47,837	23,918	23,919
RECEIVABLES FROM PARENT; SUB;AFFILIATES	74,263	-	74,263
HEALTH CARE RECEIVABLE	243,749	7,068	236,681
PREPAID EXPENSES	35,101	35,101	-
TOTAL ASSETS	$ 6,299,616	$ 1,741,767	$ 4,557,849

LIABILITIES, CAPITAL AND SURPLUS

CLAIMS UNPAID	**NOTE 1**	$ 1,077,300
UNPAID CLAIMS ADJUSTMENT EXPENSES	**NOTE 1**	21,550
GENERAL EXPENSES DUE OR ACCRUED	**NOTE 2**	568,067
AMOUNTS DUE TO PARENT; SUB; AFFILIATES		42,423
TOTAL LIABILITIES		$ 1,709,340
COMMON CAPITAL STOCK		$ 750
GROSS PAID IN AND CONTRIBUTED SURPLUS		3,749,450
SURPLUS NOTES		4,150,000
UNASSIGNED FUNDS (SURPLUS)	**NOTES 1, 2**	(5,276,066)
ACCRUED INTEREST ON SURPLUS NOTES		224,375
TOTAL CAPITAL AND SURPLUS		$ 2,848,509
TOTAL LIABILITIES; CAPITAL AND SURPLUS		$ 4,557,849

SUMMARY OF OPERATIONS

Member months		22,340
Net premium income	$ 12,981,628	
Total revenues		$ 12,981,628
Hospital/medical benefits	$ 7,722,443	
Other professional services	781,163	
Outside referrals	666,263	
Emergency room and out-of-area	174,095	
Prescription drugs	1,162,929	
Incentive pool; withhold adjustments and bonus amounts	(272,665)	
Net reinsurance recoveries	(34,215)	
Total hospital and medical		$ 10,200,013
Claims adjustment expenses	$ 987,256	
General administrative expenses	3,167,355	
Total underwriting deductions		$ 14,354,624
Net underwriting loss		$ (1,372,996)
Net investment income earned	$ 91,709	
Net loss		$ (1,281,287)

CAPITAL AND SURPLUS ACCOUNT

Capital and surplus prior reporting year		$ 2,221,919
Net loss	$ (1,281,287)	
Change in net deferred income tax	498,000	
Change in nonadmitted assets	(356,787)	
Change in surplus notes	800,000	
Change in paid-in capital	1,250,000	
Examination changes	(283,336)	
Net change in capital and surplus	626,590	
Capital and surplus end of reporting year		$ 2,848,509

EXAMINATION CHANGES

Capital and Surplus per Company, December 31, 2005:				
Common capital stock			$ 750	
Surplus notes			4,150,000	
Gross paid in and contributed surplus			3,749,450	
Accrued interest-surplus notes			224,375	
Unassigned funds (surplus)			(4,992,730)	
Total surplus as regards policyholders				$ 3,131,845
		INCREASE IN SURPLUS	**DECREASE IN SURPLUS**	
Claims unpaid	Note 1		(162,300)	
Unpaid claims adjustment expense	Note 1		(2,750)	
General expenses due or accrued	Note 2		(118,286)	
Net Increase/(Decrease) in surplus				(283,336)
Capital and Surplus per Examination, December 31, 2005:				
Common capital stock				$ 750
Surplus notes				4,150,000
Gross paid in and contributed surplus				3,749,450
Accrued interest-surplus notes				224,375
Unassigned funds (surplus)				(5,276,066)
Total Capital and Surplus				$ 2,848,509

NOTES TO FINANCIAL STATEMENTS

NOTE 1	Unpaid Claims	$1,077,300
	Unpaid Claims Adjustment Expense	2,750

The Department's consulting actuary, Milliman, recommended that year-end unpaid claims be increased to $1,077,300. Because unpaid claims adjustment expense is calculated as a percentage of unpaid claims, the actuary recommended a corresponding increase in unpaid claims adjustment expense.

NOTE 2	General Expenses Due or Accrued	$568,067

Twelve invoices totaling $118,286 were omitted from the year-end accrual for general expenses due. These invoices represented services provided in December 2005. The Company should implement procedures to ensure that year-end accruals accurately reflect incurred expenses.

GENERAL COMMENTS OR RECOMMENDATIONS

Conflict of interest Page 5

Signed conflict-of-interest disclosure statements were not completed by all directors for each year under examination. The Company should ensure that signed conflict-of-interest disclosure statements are executed annually by all officers and directors.

Accounts and Records Page 9

The Department's consulting actuary, Milliman, made the following two recommendations:

"It is recommended that a margin (for adverse deviation) be included (in the unpaid claims liability) per Section 3.3.1c of the Actuary Standard of Practice #5 and Section III.G of the NAIC Health Reserves Guidance Manual.

"As the Company has a relatively small population and limited experience, the Company should monitor the behavior of large claims in the future to determine the method for handling such claims."

SUBSEQUENT EVENTS

In February 2006, the shareholders of Essence's parent, American Multispecialty Group, Inc., voted to reorganize the Company. The reorganization would transfer ownership of Essence from its parent directly to the shareholders of American Multispecialty Group, Inc. The reorganization would require the approval of the Missouri Department of Insurance. To date, Departmental approval has not been requested.

On March 27, 2006, the board of directors authorized the issuance of a seventh surplus note to the Company's parent. The note, dated March 31, 2006, has a face value of $200,000 and pays interest at a rate of 7.5% per year. A Form D was properly filed with the Missouri Department of Insurance.

ACKNOWLEDGMENT

The assistance and cooperation extended by Essence Inc. during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Joseph Hofmeister, examiner for the Missouri Department of Insurance, participated in this examination.

VERIFICATION

State of Pennsylvania)
) ss
City of Blue Bell)

I, Thomas J. Cunningham, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Thomas J. Cunningham
Thomas J. Cunningham, CPA, CFE
Examiner-in-Charge
Missouri Department of Insurance

Sworn to and subscribed before me this 15th day of June 2006.
My commission expires:

COMMONWEALTH OF PENNSYLVANIA
NOTARIAL SEAL
KIM E. ROTH, Notary Public
Whitpain Twp., Montgomery County
My Commission Expires April 25, 2009

Notary Public

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with the National Association of Insurance Commissioners procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Christiana Dugopolski
Christiana Dugopolski, CPA, CFE
Audit Manager
Missouri Department of Insurance

LEWIS, RICE & FINGERSH, L.C.

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August 18, 2006

<u>VIA E-MAIL AND</u>
<u>OVERNIGHT DELIVERY</u>

Mr. Kirk Schmidt, CFE, CPA
Chief Financial Examiner
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Re: Essence Inc. - Examination Report of Essence Inc. for Period Ending December 31, 2005

Dear Kirk:

As discussed in our recent conference call, Essence Inc. (the "Company") asks that the responses noted below be included in the final Examination Report as a public document.

(1) <u>Conflict of Interest Response</u>. The Company will obtain signed conflict-of-interest disclosures from all officers and directors. The Company will implement procedures that are designed to ensure that the conflict-of-interest disclosures are signed annually by all officers and directors.

(2) <u>Accounts and Records Response</u>. The Company does include a margin for adverse deviation in the unpaid claims liability. The Company will review its policies for determining the amount of the margin that is included and, if necessary, implement changes to the determination of the margin to conform to the applicable legal requirements. The Company will consider a process to monitor large claims and evaluate the feasibility of developing a separate method for handling such claims.

(3) <u>Year End Accruals Response (see recommendation/comment in Note 2 on page 14 of the draft report)</u>. The Company has changed its accounts payable procedures; such that, all invoices are now received by the Company's finance department. This change in procedures will enable the Company's finance department to more accurately reflect incurred expenses in the monthly and year end accruals.

If you have any questions regarding the comments set forth above, please give me a call at your earliest convenience.

Sincerely yours,

Lynn A. Hinrichs

LAH/jjf
Enclosures (1315647)
cc: Paul A. Beuttenmuller, Jr.
Lisa McGinnis